

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 49

[REG-118620-97]

RIN 1545-AV63

Communications Excise Tax; Prepaid Telephone Cards

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed rules for the application of the communications excise tax to prepaid telephone cards (PTCs). The regulations implement certain changes made by the Taxpayer Relief Act of 1997. They affect certain telecommunications carriers, resellers, and purchasers of PTCs. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by, March 17, 1998.

Outlines of topics to be discussed at the public hearing scheduled for May 5, 1999, must be received by April 14, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-118620-97), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-118620-97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC.

Alternatively, taxpayers may submit comments electronically via

the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the hearing, submission of written comments, and to be placed on the building access list to attend the hearing, LaNita VanDyke, (202) 622-7180; concerning the regulations, Bernard H. Weberman (202) 622-3130 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collection of information should be received by, February 16, 1998. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the

Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in §49.4251-4(d)(2). This information is required to document the status of certain purchasers of PTCs. The collection of information is required to obtain a benefit. The likely respondents and recordkeepers are businesses and small businesses.

Estimated total annual reporting burden: 24 hours.

Estimated average burden per respondent: .25 hour.

Estimated number of respondents: 96.

Estimated annual frequency of responses: On occasion.

Estimated total annual recordkeeping burden: 10 hours.

Estimated average annual burden per recordkeeper: 1.2 hours.

Estimated number of recordkeepers: 8.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Section 4251 imposes a 3 percent excise tax on amounts paid for three communications services: local telephone service, toll telephone service, and teletypewriter exchange service. The tax is paid by the person paying for those communications services and, under section 4291, is collected by the person receiving that payment.

Section 1034 of the Taxpayer Relief Act of 1997 added section 4251(d), effective November 1, 1997, which provides special rules for the treatment of PTCs. Under section 4251(d), a PTC is any card or similar arrangement that permits its holder to obtain communications services and to pay for such services in advance. The face amount of the PTC is treated as an amount paid for communications services and that amount is treated as paid when the PTC is transferred by any telecommunications carrier to any person that is not a carrier.

Explanation of Provisions

These proposed regulations provide rules relating to the imposition of tax, the determination of the face amount upon which tax is imposed, and the identification of the person liable for tax and the person responsible for collecting tax. The purpose of the rules for determining the face amount is to implement Congressional intent that the tax be imposed on a PTC's retail value, whether a carrier sells a PTC at retail or at wholesale to a transferee reseller. In certain limited circumstances, these rules permit the use of a safe harbor under which the face amount is equal to \$0.30 per minute of service provided. Because the IRS and Treasury expect the retail value of PTCs to change over time and intend to review the per-minute rate at regular intervals, this safe harbor expires on December 31, 2001.

For purposes of determining whether a transferor is a carrier and whether a transferee is a person that is not a carrier, the proposed regulations adopt the definition of telecommunications carrier used by the Federal Communications Commission. In general, this definition treats any provider of telecommunications service as a telecommunications carrier. In addition, the proposed regulations provide that a transferor carrier is not responsible for collecting the tax if it has been notified, in writing, by the purchaser of the purchaser's status as a carrier and has no reason to believe otherwise. Providing that notification does not relieve the purchaser from liability

for tax if the purchaser is not, in fact, a carrier. Furthermore, the rules in the Excise Tax Procedural Regulations (26 CFR part 40) relating to collectors of tax under chapter 33 of the Internal Revenue Code do not apply to noncarrier purchasers.

During the development of the proposed regulations, the IRS and Treasury received inquiries concerning the treatment of multi-use cards and enhanced services cards. Multi-use cards are PTCs that can also be used to purchase items other than communications services, such as gas, groceries, etc. Enhanced services cards are PTCs that can also be used to purchase nontaxable informational services such as stock quotations or access to a 900 number. The proposed regulations do not include special rules for multi-use or enhanced services cards. However, the IRS and Treasury request comments on this issue.

The regulations are proposed to be effective at the beginning of the first calendar quarter after they are published as final regulations. Carriers and transferees may, however, rely on the proposed rules in determining the treatment of PTCs transferred before the effective date.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply

to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the time required to prepare or retain the notification is minimal and will not have a significant impact on those small entities that are required to provide notification. Furthermore, notification is provided only once to each seller. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Wednesday, May 5, 1999, at 10 a.m. in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access

restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having a visitor's name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT caption.

An outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) must be submitted by any person that wishes to present oral comments at the hearing. Outlines must be received by April 14, 1999.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving requests to speak has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Bernard H. Weberman, Office of Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 49

Excise taxes, Reporting and recordkeeping requirements, Telephone, Transportation.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 49 is proposed to be amended as follows:

PART 49--FACILITIES AND SERVICES EXCISE TAXES

Paragraph 1. The authority citation for part 49 is revised to read as follows:

Authority: 26 U.S.C. 7805, unless otherwise noted.

Section 49.4251-4 also issued under 26 U.S.C. 4251(d).

Par. 2. Section 49.4251-4 is added to read as follows:

§49.4251-4 Prepaid telephone cards.

(a) In general. In the case of communications services acquired by means of a prepaid telephone card (PTC), the face amount of the PTC is treated as an amount paid for communications services and that amount is treated as paid when the PTC is transferred by any carrier to any person that is not a carrier. This section provides rules for the application of the section 4251 tax to PTCs.

(b) Definitions.

Carrier means a telecommunications carrier as defined in 47 U.S.C. 153.

Comparable PTC means a currently available dollar card or tariffed unit card (other than a PTC transferred in bulk or under special circumstances, such as for promotional purposes) that provides the same type and amount of communications services as the PTC to which it is being compared.

Dollar card means a PTC the value of which is designated by the carrier in dollars (even if also designated in units of service), provided that the designated value is not less than the amount for which the PTC is expected to be sold to a holder.

Holder means a person that purchases other than for resale.

Prepaid telephone card (PTC) means a card or similar arrangement that permits its holder to obtain a fixed amount of communications services by means of a code (such as a personal identification number (PIN)) or other access device provided by the carrier and to pay for those services in advance.

Tariff means a schedule of rates and regulations filed by a carrier with the Federal Communications Commission.

Tariffed unit card means a unit card that is transferred by a carrier--

(1) To a holder at a price that does not exceed the designated number of units on the PTC multiplied by the carrier's tariffed price per unit; or

(2) To a transferee reseller subject to a contractual or other arrangement under which the price at which the PTC is sold to a holder will not exceed the designated number of units on the PTC multiplied by the carrier's tariffed price per unit.

Transferee means the first person that is not a carrier to whom a PTC is transferred by a carrier.

Transferee reseller means a transferee that purchases a PTC for resale.

Unit card means a PTC other than a dollar card.

Untariffed unit card means a unit card other than a tariffed unit card.

(c) Determination of face amount--(1) Dollar card. The face amount of a dollar card is the designated dollar value.

(2) Tariffed unit card. The face amount of a tariffed unit card is the designated number of units on the PTC multiplied by the tariffed price per unit.

(3) Untariffed unit card--(i) Transfer to holder. The face amount of an untariffed unit card transferred by a carrier to a holder is the amount for which the carrier sells the PTC to the holder.

(ii) Transfer to transferee reseller--(A) In general. The face amount of an untariffed unit card transferred by a carrier to a transferee reseller is, at the option of the carrier,--

(1) The highest amount for which the carrier sells an identical PTC to a holder that ordinarily would not be expected to buy more than one such PTC at a time (if the carrier makes such sales on a regular and arm's-length basis) or the face amount of a comparable PTC (if the carrier does not make such sales on a regular and arm's-length basis);

(2) 165 percent of the amount for which the carrier sells the PTC to the transferee reseller (including in that amount, in addition to any sum certain fixed at the time of the sale, any contingent amount per unit multiplied by the designated number of units on the PTC); or

(3) If the PTC is transferred before January 1, 2002, and is of a type that ordinarily is used entirely for domestic communications service, \$0.30 multiplied by the maximum number of minutes of domestic communications service on the PTC.

(B) Sales not at arm's length. In the case of a transfer of an untariffed unit card by a carrier to a transferee reseller otherwise than through an arm's-length transaction, the fair market retail value of the PTC shall be substituted for the amount determined in paragraph (c)(3)(ii)(A)(2) of this section.

(4) Exclusion. Any separately stated state or local tax imposed on the furnishing or sale of communications services and any separately stated section 4251 tax are disregarded in determining, for purposes of this paragraph (c), the amount for which a PTC is sold.

(d) Liability for tax--(1) In general. Under section 4251(d), the section 4251(a) tax is imposed on the transfer of a PTC by a carrier to a transferee. The person liable for the tax is the transferee. Except as provided in paragraph (d)(2) of this section, the person responsible for collecting the tax is the carrier transferring the PTC to the transferee. If a holder purchases a PTC from a transferee reseller, the amount the holder pays for the PTC is not treated as an amount paid for communications services and thus tax is not imposed on that payment.

(2) Effect of statement that purchaser is a carrier--(i) On transferor. A carrier that transfers a PTC to a purchaser is not responsible for collecting the tax if, at the time of transfer, the transferor carrier has received written notification from the purchaser that the purchaser is a carrier, and the transferor has no reason to believe otherwise. The notification to be provided by the purchaser is a statement, signed under penalties of perjury by a person with authority to bind the purchaser, that the purchaser is a carrier (as defined in paragraph (b) of this section). The statement is not required to take any particular form.

(ii) On purchaser. If a purchaser that is not a carrier provides the notification described in paragraph (d)(2)(i) of this section to the carrier that transfers a PTC, the purchaser remains liable for the tax imposed on the transfer of the PTC.

(3) Exemptions. Any exemptions available under section 4253 apply to the transfer of a PTC from a carrier to a holder. Section 4253 does not apply to the transfer of a PTC from a carrier to a transferee reseller.

(e) Examples. The following examples illustrate the provisions of this section:

Example 1. Unit card; sold to individual. (i) On February 1, 2000, A, a carrier, sells a prepaid telephone card at A's retail store to P, an individual, for P's use in making telephone calls. A provides P with a PIN. The face of the card is marked "400 minutes." The sales price is \$100. A tariff has not been filed for the units on the card. The toll telephone service acquired by purchasing the card will be obtained by entering the PIN and the telephone number to be called.

(ii) Because P purchased from a carrier other than for resale, P is a holder. The card provides its holder, P, with a fixed amount of communications services (400 minutes of toll telephone service) to be obtained by means of a PIN, for which P pays in advance of obtaining service; therefore, the card is a PTC. Because the value of the PTC is not designated in dollars and a tariff has not been filed for the units on the PTC, the PTC is an untariffed unit card. Because it is transferred by the carrier to the holder, the face amount is the sales price (\$100).

(iii) The card is a PTC; thus, under section 4251(d), the face amount is treated as an amount paid for communications services and that amount is treated as paid when the PTC is transferred from A to P. Accordingly, at the time of transfer, P is liable for the 3 percent tax imposed by section 4251(a). The tax is \$3 ($3\% \times \100 (the face amount of the PTC)). Thus, the total paid by P is \$103, the \$100 sales price plus \$3 tax. A is responsible for collecting the tax from P.

Example 2. Unit card; given to individual. (i) The facts are the same as in Example 1, except that instead of selling a card, A gives a 40 minute card to P.

(ii) Although the card provides P with a fixed amount of communications services (40 minutes of toll telephone service) to be obtained by means of a PIN, P does not pay for the service. Therefore, the card is not a PTC, even though it is called a "prepaid telephone card" by A.

(iii) Because the card is not a PTC, section 4251(d) does not apply. Furthermore, no tax is imposed by section 4251(a) because no amount is paid for the communications services.

Example 3. Unit card; adding value. (i) After using the card described in Example 2, P arranges with A by telephone to have 400 minutes of toll telephone service added to the card. The sales price is \$100. P is told to continue using the PIN provided with the card.

(ii) Because P purchased from a carrier other than for resale, P is a holder. The arrangement provides its holder, P, with a fixed amount of communications services (400 minutes of toll telephone service) to be obtained by means of a PIN, for which P pays in advance of obtaining service; therefore, the arrangement is a PTC. Because the value of the PTC is not designated in dollars and a tariff has not been filed for the units on the PTC, the PTC is an untariffed unit card. Because it is transferred by the carrier to the holder, the face amount is the sales price (\$100).

(iii) The arrangement is a PTC; thus, under section 4251(d), the face amount is treated as an amount paid for communications

services and that amount is treated as paid when the PTC is transferred from A to P. Accordingly, at the time of transfer, P is liable for the 3 percent tax imposed by section 4251(a). The tax is \$3 ($3\% \times \100 (the face amount of the PTC)). Thus, the total paid by P is \$103, the \$100 sales price plus \$3 tax. A is responsible for collecting the tax from P.

Example 4. Dollar card; sold other than for resale. (i) On February 1, 2000, B, a carrier, sells 100,000 prepaid telephone cards to Q, an auto dealer. Q will give away a card to each person that visits Q's dealership. B provides Q with a PIN for each card. The face of each card is marked "\$2." The sales price for the 100,000 cards is \$50,000. The toll telephone service acquired by purchasing the card will be obtained by entering the PIN and the telephone number to be called.

(ii) Because Q purchased from a carrier other than for resale, Q is a holder. Each card provides its holder, Q, with a fixed amount of communications services (\$2 of toll telephone service) to be obtained by means of a PIN, for which Q pays in advance of obtaining service; therefore, each card is a PTC even though Q's visitors do not pay for the cards. The value of each PTC is designated in dollars; therefore, each PTC is a dollar card. Because the PTC is a dollar card, the face amount is the designated dollar value (\$2).

(iii) The cards are PTCs; thus, under section 4251(d), the face amount is treated as an amount paid for communications services and that amount is treated as paid when the PTCs are transferred from B to Q. Accordingly, at the time of transfer, Q is liable for the 3 percent tax imposed by section 4251(a). The amount of the tax is computed as follows: $3\% \times \$2$ (the face amount of the PTC) = \$0.06 per PTC \times 100,000 PTCs = \$6,000 tax. Thus, the total paid by Q is \$56,000, the \$50,000 sales price plus \$6,000 tax. B is responsible for collecting the tax from Q.

Example 5. Unit card; sold to transferee reseller. (i) On February 1, 2000, C, a carrier, sells 10,000 prepaid telephone cards to R, a convenience store owner. R will sell the cards to individuals for their own use. C provides R with a PIN for each card. The face of each card is marked "400 minutes." A tariff has not been filed for the units on the card. C's sales price to R is \$40,000 to be paid at the time of sale, plus a contingent amount equal to \$0.14 for each minute of service used within 12 months to be paid at the end of the 12-month period. C also sells the identical card at its retail store for \$110 to customers purchasing one card, or for \$90 each to customers purchasing five or more cards. The toll telephone service acquired by purchasing the card will be obtained by entering the PIN and the telephone number to be called.

(ii) Because R purchased from a carrier for resale, R is a transferee reseller. Because R's customers will purchase other than for resale they will be holders. Each card sold by R provides its holder, R's customer, with a fixed amount of communications services (400 minutes of toll telephone service) to be obtained by means of a PIN, for which R's customer pays in advance of obtaining service; therefore, each card is a PTC. Because the value of each PTC is not designated in dollars and a tariff has not been filed for the units on the PTC, each PTC is an untariffed unit card.

(iii) The PTCs are untariffed unit cards transferred by the carrier to a transferee reseller. Thus, the face amount is determined under paragraph (c)(3)(ii) of this section, which permits C to choose from three alternative methods. Under paragraph (c)(3)(ii)(A)(1) of this section, the face amount of each PTC would be \$110, the highest amount for which C sells to customers purchasing a single PTC. Alternatively, under paragraph (c)(3)(ii)(A)(2) of this section, a face amount of \$99 per PTC may be used. This face amount is computed as follows: $165\% \times \$600,000$ (the \$40,000 sum certain plus the \$560,000 contingent amount (10,000 PTCs x 400 units = 4,000,000 units x \$0.14 per unit)) = \$990,000 ÷ 10,000 (the total number of PTCs sold). Finally, under paragraph (c)(3)(ii)(A)(3) of this section (assuming the PTCs are of a type that ordinarily is used entirely for domestic communications services), a face amount of \$120 (\$0.30 per unit x 400 units) may be used.

(iv) The cards are PTCs; thus, under section 4251(d), the face amount is treated as an amount paid for communications services and that amount is treated as paid when the PTCs are transferred from C to R. Accordingly, at the time of transfer, R is liable for the 3 percent tax imposed by section 4251(a). The amount of the tax is computed as follows (assuming that C chooses to determine the face amount as provided in paragraph (c)(3)(ii)(A)(2) of this section): $3\% \times \$99$ (the face amount of the PTC) = \$2.97 per PTC x 10,000 PTCs = \$29,700 tax. Thus, the total paid by R at the time of transfer is \$69,700, the \$40,000 sum certain plus \$29,700 tax. C is responsible for collecting the tax from R.

(v) In 2000 and 2001, R sells PTCs to its customers for varying amounts. Because any amount paid for a PTC purchased from a transferee reseller is not an amount paid for communications services, no tax is imposed on R's sale of a PTC.

(vi) On February 15, 2001, C informs R that 3,000,000 minutes were used during the 12-month period. R pays C \$420,000 (\$0.14 x 3,000,000), the contingent amount agreed to when R purchased the PTCs. No tax is imposed on this payment. Tax was imposed when the PTCs were transferred to R. The contingent

amount paid in 2001, based on the number of minutes used, does not change R's tax liability.

Example 6. Tariffed unit card; sold to transferee reseller.

(i) On February 1, 2000, D, a carrier, sells 1,000 prepaid telephone cards to S, a convenience store owner, for \$25,000. The value of the cards is not denominated in dollars, but the face of the card is marked "100 minutes" and a tariff of \$0.33 per minute has been filed for the units on the card. S agrees that it will sell the cards to individuals for their own use and at a price that does not exceed \$0.33 per minute. S actually sells the cards for \$30 each (i.e., at a price of \$0.30 per minute). D provides S with a PIN for each card. The toll telephone service acquired by purchasing the card will be obtained by entering the PIN and the telephone number to be called.

(ii) Because S purchased from a carrier for resale, S is a transferee reseller. Because S's customers will purchase other than for resale they will be holders. Each card sold by S provides its holder, S's customer, with a fixed amount of communications services (100 minutes of toll telephone service) to be obtained by means of a PIN, for which S's customer pays in advance of obtaining service; therefore each card is a PTC. Because the value of each PTC is not designated in dollars and D sells the PTCs to S subject to an arrangement under which the price at which the PTCs are sold to holders will not exceed the designated number of units on the PTC multiplied by D's tariffed price per unit, each PTC is an tariffed unit card. Because the PTCs are tariffed unit cards, the face amount of each PTC is \$33, the designated number of units on the PTC multiplied by the tariffed price per unit ($100 \times \$0.33 = \33), even though the actual retail sale price of the cards is \$30.

(iii) The cards are PTCs; thus, under section 4251(d), the face amount is treated as an amount paid for communications services and that amount is treated as paid when the PTC is transferred from D to S. Accordingly, at the time of transfer, S is liable for the 3 percent tax imposed by section 4251(a). The tax is \$990 ($3\% \times \$33,000$ (1,000 PTCs multiplied by the \$33 face amount of each PTC)). Thus, the total paid by S is \$25,990, the \$25,000 sales price plus \$990 tax. D is responsible for collecting the tax from S.

Example 7. Transfer of card that is not a PTC. (i) On February 1, 2000, E, a carrier, provides a telephone card to T, an individual, for T's use in making telephone calls. E provides T with a PIN. The card provides access to an unlimited amount of communications services. E charges T \$0.25 per minute of service, and bills T monthly for services used. The communications services acquired by using the card will be obtained by entering the PIN and the telephone number to be

called.

(ii) Although the communications services will be obtained by means of a PIN, T does not receive a fixed amount of communications services. Also, T cannot pay in advance since the amount of T's payment obligation depends upon the number of minutes used. Therefore, the card is not a PTC.

(iii) Because the card is not a PTC, section 4251(d) does not apply. However, the tax imposed by section 4251(a) applies to the amounts paid by T to E for communications services. Accordingly, at the time an amount is paid for communications services, T is liable for tax. E is responsible for collecting the tax from T.

(f) Effective date. This section is applicable with respect to PTCs transferred by a carrier on or after the first day of the first calendar quarter beginning after the date of publication of the final regulations in the **Federal Register**.

Michael P. Dolan

Deputy Commissioner of Internal Revenue